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Submitted via email (director@fasb.org)

October 21, 2010

Re: File Reference 1820-100  
International Accounting Standards Board and Financial Accounting  
Standards Board Exposure Draft on Revenue Recognition (Topic 605)  
Revenue from Contracts with Customers

Dear Sir/Madam,

Thank you for the opportunity to provide comments on your Joint Exposure Draft on Revenue from Contracts with Customers.

I am a Corporate Vice President and the Corporate Controller of Cadence Design Systems Inc., a company that enables global electronic design innovation and plays an essential role in the creation of today's integrated circuits and electronics. Customers use Cadence software and hardware, methodologies, and services to design and verify advanced semiconductors, consumer electronics, networking and telecommunications equipment, and computer systems. The company is headquartered in San Jose, California, with sales offices, design centers, and research facilities around the world to serve the global electronics industry. Cadence employs approximately 4,600 people worldwide.

We are generally supportive of your efforts to move toward one “principles based” universal standard and congratulate you on your efforts to date. We are committed to strong corporate governance and recognize the need to simplify accounting guidance related to Revenue from Contracts with Customers. This letter represents Cadence’s view and is being submitted to both the FASB and IASB.
Accelerating revenue recognition for ‘non-exclusive’ time based software licenses will dramatically reduce comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets.

This point is perhaps best illustrated by way of example. Assume, there are two, almost identical software vendors, selling very similar software products, to the exact same creditworthy customer, for the exact same price. Also, let’s say that each software vendor executes identical contracts that provide this customer, with the non-exclusive right to use the software vendor’s products, including future products, when and if available, and both software vendor’s provide the software and its associated access codes, to the customer at regular monthly intervals, throughout the duration of their contract.

However, for the sake of comparison, let’s say that the only difference between these two software vendors is that one vendor executes and renews its contract with the customer on an annual basis, and the other software vendor executes and renews their contract every three years. Please see Table 1.1 below for an illustration of the basic details of each software subscription:

<table>
<thead>
<tr>
<th>S/W Vendor</th>
<th>Duration (years)</th>
<th>Fee</th>
<th>Annual value</th>
<th>Quarterly payment</th>
</tr>
</thead>
<tbody>
<tr>
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<td>$1m</td>
<td>$1m</td>
<td>$0.25m</td>
</tr>
<tr>
<td>Beta</td>
<td>3</td>
<td>$3m</td>
<td>$1m</td>
<td>$0.25m</td>
</tr>
</tbody>
</table>

Under existing rules, software firms would currently recognize revenue, for the type of subscription arrangement described above, evenly over the duration of the subscription period. That is, with revenue of $250,000 recognized every quarter, for the duration of these contracts. An illustration of the revenue timing over a six year period is illustrated below in Table 1.2. For ease of illustration, I’ve assumed zero price increases:

<table>
<thead>
<tr>
<th>S/W Vendor / Year</th>
<th>20X1</th>
<th>20X2</th>
<th>20X3</th>
<th>20X4</th>
<th>20X5</th>
<th>20X6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alpha</td>
<td>$1m</td>
<td>$1m</td>
<td>$1m</td>
<td>$1m</td>
<td>$1m</td>
<td>$1m</td>
</tr>
<tr>
<td>Beta</td>
<td>$1m</td>
<td>$1m</td>
<td>$1m</td>
<td>$1m</td>
<td>$1m</td>
<td>$1m</td>
</tr>
</tbody>
</table>

The benefits of this approach include, but are not limited to, the following:-

- Revenue timing is a fair reflection of the substance of each arrangement.
- Revenue accounting is relatively simple and improves comparability of revenue between the two software vendors.
- The accounting fairly reflects the economics of the transaction since the software vendor has a constant and continuous obligation to deliver software products, and
- The revenue timing is consistent with how the purchaser would typically record the expense for each contract.
If we understand the proposed guidance correctly, each software firm would be required to recognize a large portion of the revenue immediately, at the beginning of the subscription period, where the right to use the software is ‘non-exclusive’.

A comparison of the resulting revenue is illustrated in Tables 1.2 and 1.3 below:

<table>
<thead>
<tr>
<th>Table 1.2 (Revenue Timing - Existing Guidance)</th>
</tr>
</thead>
<tbody>
<tr>
<td>S/W Vendor / Year</td>
</tr>
<tr>
<td>-------------------</td>
</tr>
<tr>
<td>Alpha</td>
</tr>
<tr>
<td>Beta</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Table 1.3 (Revenue Timing - Proposed Guidance)</th>
</tr>
</thead>
<tbody>
<tr>
<td>S/W Vendor / Year</td>
</tr>
<tr>
<td>-------------------</td>
</tr>
<tr>
<td>Alpha</td>
</tr>
<tr>
<td>Beta</td>
</tr>
</tbody>
</table>

As Table 1.3 above illustrates, the timing of revenue recognition from similar license subscription arrangements is significantly different, yet, the only difference in the two arrangements is the duration of the contract. Another point that should not be understated here is “how would the ‘Beta Company’ determine that $2m was the appropriate amount of revenue to recognize in the first year of the contract?” For companies like Cadence, where vendor specific objective evidence (or “VSOE”) of fair value does not exist for our software products, and a significant volume of new technology is made available to subscription customers over the duration of a contract, the application of the proposed guidance would require considerable judgment to determine how much revenue should be assigned to the first delivery of software products and how much should be assigned to each subsequent delivery.

**Downgrading ‘credit risk’ to just a measurement of revenue is a reduction in standards, at a time when we should be seeking to improve standards.**

We do not agree that the customer’s credit risk should affect how much revenue an entity recognizes when it satisfies a performance obligation rather than whether the entity recognizes revenue.

The proposed lowering of the existing standard will result in a much larger degree of subjectivity, which in turn would cause an increased level of complexity and expense related to credit assessments, because we believe it would create an unnecessary administrative burden that merely changes when revenue is recognized and how revenue is classified.

We also respectfully disagree with the concept that future adjustments to the credit risk estimate should flow through other income and expense. We believe that this aspect of the proposed guidance raises questions with regard to the very definition of “revenue”, and this would inevitably result in a reduction in the comparability of revenue recognition practices across entities.
We believe it is inappropriate to break the link between revenue and the net of tax, cash consideration received from a customer

Although this is not significant to Cadence, we respectfully disagree with the proposal that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit)

Perhaps this particular proposal is more relevant to other industries, but generally, we have difficulty with the concept of recognizing more revenue than the cash consideration received, which would be the case when payment is received in advance of revenue being earned.

If this aspect of the proposed guidance is retained, we would recommend that you allow companies to “opt out” of applying this particular guidance, as we fear that it could cause more confusion than clarity. We also fear that this particular measure raises questions with regard to the very definition of “revenue” and is likely to result in more confusion than clarity.

**Retrospective application of this guidance would be incredibly expensive and complex and we strongly question whether the benefit is justified by the cost**

We agree that retrospective application would preserve trend information and if some companies can implement the proposed guidance retrospectively, we believe they should be allowed to do so, but we don’t believe that retrospective application should be mandatory.

We would find retrospective application of some of the proposed guidance to be an incredibly daunting task, likely requiring many man-years of effort and significant expense to implement. We question if the benefits of this particular aspect of the proposal to the user would outweigh the implementation costs and risks to the company. The complexity and potential for error is enormous.

It would be far more practical and shareholder friendly to apply the proposed guidance on a prospective basis, with suitable disclosures wherever possible.

Also, we strongly suspect that many shareholders would accept a temporary lapse in trend information about revenue rather than suffer the massive cost associated with trying to implement retrospective application of the proposed guidance.
While we fully appreciate that it’s difficult to achieve a ‘one size fits all’ standard, we believe that the existing subscription, or ‘ratable’, revenue accounting would serve well as a ‘rebuttable’ presumption, which would allow software vendors a simple accounting solution, consistent with the economics of most transactions, and we would encourage you to consider amending your guidance to allow ‘ratable’ revenue recognition where the economics of the transaction supports that accounting treatment.

Please note that we have also provided responses to the specific questions asked in the exposure draft, in the Appendix to this letter.

I hope these comments are useful to you. I would be pleased to respond to any questions or comments you may have regarding this matter.

Yours sincerely,

G. Sean Sobers, CPA (inactive)
Corporate Controller
Appendix

Question 1

Paragraphs 12–19 propose a principle (price interdependence) to help an entity determine whether to:

(a) combine two or more contracts and account for them as a single contract;
(b) segment a single contract and account for it as two or more contracts; and
(c) account for a contract modification as a separate contract or as part of the original contract.

Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

We agree with the principle.

Question 2

The Boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

Generally, we agree with the principle. However, we don’t believe it is necessary for a performance obligation to have a distinct profit margin. We would recommend that a performance obligation is distinct if that offering could be subject to a separate purchasing decision by the purchaser, or if it could be sold separately by the vendor.

Question 3

Do you think that the proposed guidance in paragraphs 25–31 and related implementation guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

We believe the proposed guidance is sufficient. However, we feel the guidance would benefit greatly from the provision of a number of additional examples, particularly in relation to paragraph 30(a), when a customer either disputes payment, or might not be considered creditworthy.
Question 4

The Boards propose that if the amount of consideration is variable, an entity should recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.

Do you agree that an entity should recognize revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognizing revenue when the transaction price is variable and why?

We agree that if the amount of consideration is variable, an entity should recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. However, where the entity does not have experience with similar types of contracts (or access to the experience of other entities if it has no experience of its own), we believe the entity should be able to use management’s best estimate, with appropriate disclosures wherever necessary.

Question 5

Paragraph 43 proposes that the transaction price should reflect the customer’s credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer’s credit risk should affect how much revenue an entity recognizes when it satisfies a performance obligation rather than whether the entity recognizes revenue? If not, why?

We do not agree that the customer’s credit risk should affect how much revenue an entity recognizes when it satisfies a performance obligation rather than whether the entity recognizes revenue.

Please see our cover letter for further discussion of this topic.

Question 6

Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

Although this is not significant to Cadence, we respectfully disagree with the proposal. We have significant difficulty with the concept of recognizing more revenue than the cash consideration received, for example, when payment is received in advance.

Please see our cover letter for further discussion of this topic.
Question 7

Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the standalone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?

We generally agree with the principle that the transaction price should be allocated to all separate performance obligations in proportion to the standalone selling price (estimated if necessary). However, it would be useful to have some additional guidance explaining how estimated selling prices should be established when vendor specific objective evidence (or "VSOE") of fair value does not exist for one or more performance obligations.

When looking at Cadence's business, we believe that the use of the residual method generally produces the most appropriate and consistent method of allocating the transaction price to the separate performance obligations in our contracts, and would like to see the residual method, or some derivative of the residual method, retained as an appropriate method for allocating transaction price to separate performance obligations.

Question 8

Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, Topic 330 or IAS 2; Topic 360 or IAS 16; and Topic 985 on software or IAS 38, Intangible Assets), an entity should recognize an asset only if those costs meet specified criteria.

Do you think that the proposed guidance on accounting for the costs of fulfilling a contract is operational and sufficient? If not, why?

We believe the proposed guidance on accounting for the costs of fulfilling a contract is operational and sufficient.
Question 9

Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognizing an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognized for an onerous performance obligation.

Do you agree with the costs specified? If not, what costs would you include or exclude and why?

We agree that the costs specified in paragraph 58 should be capitalized when they relate to assets used to satisfy a performance obligation.

Question 10

The objective of the Boards’ proposed disclosure requirements is to help users of financial statements understand the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

The proposed disclosures are extensive and consistent with paragraph 70, we believe management should decide the level of detail necessary to satisfy the disclosure requirements and how much emphasis to place on each of the various requirements. Rather than force management to provide prescriptive disclosures, we would recommend that management discretion be allowed to determine which disclosures are of greatest relevance and meaning to users of the financial statements.

We believe that disclosures are more meaningful when they are consistent with the information that management uses to make business decisions.
Question 11

The Boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.

Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

The suggested disclosures relating to performance obligations, as outlined in paragraphs 77 and 78 of the Exposure Draft, would result in the inclusion of information that is subject to many variables, making it very difficult to audit. We believe it is more appropriate to include such information in Management’s Discussion and Analysis of Results and Operations, where management deem the information to be of sufficient benefit to users, that it warrants the cost and effort associated with producing the information. We do not agree that the proposed disclosure requirement be mandatory.

Question 12

Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing, and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

Yes, we agree.

Question 13

Do you agree that an entity should apply the proposed guidance retrospectively (that is, as if the entity had always applied the proposed guidance to all contracts in existence during any reporting periods presented)? If not, why?

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

As we point out in our cover letter, we agree that retrospective application would preserve trend information and if some companies can implement the proposed guidance retrospectively, we believe they should be allowed to do so, but we don’t believe that retrospective application should be mandatory.

Please see our cover letter for further discussion of this topic.
Question 14

The proposed implementation guidance is intended to assist an entity in applying the principles in the proposed guidance. Do you think that the implementation guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

We believe that the implementation guidance would benefit greatly from the inclusion of more examples. It is common in the software industry to deliver software “access codes” at regular intervals throughout the duration of a time based software license. The software license example included in IG45 is very simple in nature, and does not address situations where “access codes” are provided at regular intervals during the course of a contract.

Question 15

The Boards propose that an entity should distinguish between the following types of product warranties:

(a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.

(b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.

Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

We would like greater clarity with regard to what you consider to be “latent defects” versus “faults that arise after the product is transferred to the customer”, but generally we feel that the provision of a standard warranty should not give rise to a performance obligation.
Question 16

The Boards propose the following if a license is not considered to be a sale of intellectual property:

(a) if an entity grants a customer an exclusive license to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the license; and
(b) if an entity grants a customer a nonexclusive license to use its intellectual property, it has a performance obligation to transfer the license and it satisfies that obligation when the customer is able to use and benefit from the license.

Do you agree that the pattern of revenue recognition should depend on whether the license is exclusive? Do you agree with the patterns of revenue recognition proposed by the Boards? Why or why not?

We disagree that the pattern of revenue recognition should depend on whether the license is exclusive. Exclusivity is merely one fact, and we believe that all facts and circumstances need to be considered when determining when revenue has been earned.

We refer you back to the example contained in the cover letter for a more detailed discussion of this point.

Question 17

The Boards propose that in accounting for the gain or loss on the sale of some nonfinancial assets (for example, intangible assets and property, plant, and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?

We agree with this proposal.

Question 18: Should any of the proposed guidance be different for nonpublic entities (private companies and not-for-profit organizations)? If so, which requirement(s) and why?

Cadence is a public company, but we can’t imagine why the proposed guidance would be any different for private companies and not-for-profit organizations.